No. 15,607

In the United States
Court of Appeals
For the Ninth Circuit

F. M. BISTLINE AND ANNE BISTLINE,
Appellants

vs.

UNITED STATES OF AMERICA,
Appelle

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO

BRIEF FOR THE APPELLEE

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OPINION BELOW

The memorandum opinion of the District Court (R. 16-22) is reported at 145 F. Supp. 802.

JURISDICTION

Appellants filed their income tax return for 1948 on or before March 15, 1949, and thereafter the Commissioner assessed an additional tax with interest (R. 23.) After payment of such sum, appellants duly filed a claim for refund on February 14, 1952. This claim was disallowed on April 8, 1953, and a suit for refund was instituted by the filing of a complaint on March 7, 1955. (R. 3-12.) An answer was filed on behalf of the United States on May 9, 1955. (R. 13-15). After the hearing, the District Court decided one issue for the appellants and one for the United States and thus entered judgment allowing the appellants to recover $122.04. (R. 16-27.)

QUESTION PRESENTED

Whether the District Court correctly held that the property sold by taxpayer 1/ in the taxable year 1948 had been held primarily for sale to customers in the ordinary course of his business within the meaning of Section 117 of the 1939 Internal Revenue Code and that, accordingly, the profit from such sale should be taxed as ordinary income rather than as capital gain.

1/ Appellant, F. M. Bistline's wife Anne is an interested party because of the filing of a joint return of community income for the taxable year but, for convenience, reference will hereinafter be made only to the appellant F. M. Bistline, who will be called the taxpayer.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAIN AND LOSSES.

(a) [As amended by Section 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. *Definitions.*— As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * * or ** * real property used in the trade or business of the taxpayer;

* * * *

(j) [As added by Section 151(b) of the Revenue Act of 1942, *supra*] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means * * * real property used in the trade or business, held for more than 6 months, which is not * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property

used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. * * *

* * * *

(26 U. S. C. 1952 ed., Sec. 117.)

STATEMENT

The pertinent facts as found by the District Court are as follows (R. 22-24):

F. M. Bistline and Anne Bistline, the taxpayers here, are husband and wife and are residents of Pocatello, Idaho. They filed a joint income tax return for 1948. (R. 22.)

The profit realized from the sale of certain real estate was reported on taxpayers' income tax returns as long-term capital gains but the Commissioner determined that these profits were taxable as ordinary income and assessed and collected additional income taxes for these years. (R. 22-23.)

Mr. Bistline (hereinafter called the taxpayer, see footnote 1, supra) is an attorney and has maintained his own law office since 1923. The net income earned from his legal practice in 1946, was $860 and in 1947 was $934. (R. 23.)

In 15 separate transactions during 1946, taxpayer sold 34 vacant lots for a net profit of $10,950.26. In 7 transactions during 1947, he sold 10 vacant lots and a 51.03-acre tract of land for a

net profit of $9,033; and in 12 transactions during 1948, he sold 54 vacant lots and a tract of land for a net profit of $12,291.74. (R. 23.)

During the past twenty years, taxpayer purchased large numbers of vacant lots and other real estate with the intention of selling them at a profit to any prospective purchaser; and also during that period, he frequently and continuously sold a substantial number of vacant lots and other real estate. (R. 23.)

Taxpayer was engaged in the real estate business during 1946, 1947 and 1948, and the properties he sold during these three years were held by him primarily for sale to customers in the ordinary course of his real estate business. (R. 23-24.)

The District Court accordingly held that the gain realized from such sales was taxable as ordinary income for federal tax purposes. (R. 25.)

SUMMARY OF ARGUMENT

By taxpayer's failure to include in this appeal any question as to the sales of property made in 1946 and 1947 or any of the sales made in 1948, except that to Westvaco, he necessarily admits the correctness of the District Court's conclusion that all of these sales, with the one exception just referred to, involved property which was being held primarily for sale to customers in the ordinary course of his real estate business and also admits that the gain from such sales, with the exception mentioned, is taxable as ordinary income. There is no reason to treat the sale to Westvaco any differently than the other sales.

Under the applicable statutory provisions, gain

from sales of property which is being held primarily for sale to customers in the ordinary course of the trade or business is taxable as ordinary income. In contending that the tract which was sold to Westvaco was not so held, taxpayer asserts that such tract was used in farming and that such fact brings the case within the statutory provision which allows gain from property used in a trade or business to be treated as capital gain. We do not agree that such provision is applicable here and neither did the District Court. The statutory definition of property used in the trade or business specifically excludes property held primarily for sale to customers in the ordinary course of the trade or business and the question of whether property is so held is a question of fact. Thus, the burden of proving that the tract which was sold to Westvaco was not held primarily for sale was on the taxpayer and the District Court has held that he did not meet his burden of proof.

In reaching its decision the District Court applied tests which have been repeatedly approved and applied by this and other courts in cases involving similar facts, and its decision is amply supported by the facts. The record shows that the land which was sold to Westvaco was a part of a large tract and that when such sale was made about one-half of the tract had already been sold to various persons. Furthermore, no farming had ever been done on the parcel acquired by Westvaco, and taxpayer's co-owner of this tract testified that any property they held was for sale if the price offered was satisfactory. When such evidence is considered with that showing the long period during which the taxpayer has been in the real estate business, we sub-

mit it is evident that the District Court has reached a correct decision.

ARGUMENT

THE DISTRICT COURT CORRECTLY HELD THAT THE GAIN REALIZED BY THE TAXPAYER FROM THE SALE OF THE PROPERTY INVOLVED HERE DURING THE TAXABLE YEAR SHOULD BE TAXED AS ORDINARY INCOME RATHER THAN CAPITAL GAIN.

Taxpayer has appealed only from that part of the judgment of the District Court related to the sale of land to the Westvaco Chemical Company (See R. 27-28, 29-30, 48) and asserts in his brief (p. 6) that the only question involved is whether that sale is entitled to long term capital gain tax treatment. In limiting his appeal in this way, taxpayer is of course conceding the correctness of the District Court's decision as to all of the sales in this case except the one just referred to. In other words, taxpayer now necessarily admits the correctness of the District Court's conclusions that he was engaged in the real estate business during 1946, 1947 and 1948, that all of the property sold by him in 1946 and 1947 and all of the property sold by him in 1948 (except the one piece of land sold to Westvaco) was held primarily for sale to customers in the ordinary course of his real estate business, and that the gain from such sales (with the exception mentioned) is taxable as ordinary income for federal income tax purposes. (R. 23-25.) It is important to note the extent of these admissions for they have a bearing on the question which taxpayer is raising on this

appeal. This will be pointed out more specifically when we discuss the facts and show that the sale to Westvaco should be treated no differently than the other transactions which taxpayer now agrees (by his failure to seek review of the District Court's decision concerning them) resulted in gain taxable as ordinary income.

A. *Statutory provisons involved*

In objecting to the District Court's decision in so far as it applies to the land sold to Westvaco, the taxpayer argues, in substance, that such land was a capital asset which had been used in the business of farming and livestock raising, and that, in computing the tax on the gain realized from such sales, he is entitled to the preferential treatment allowed in Section 117 of the Internal Revenue Code of 1939, *supra*, but we do not agree. Section 117(a) defines capital assets as "property held by the taxpayer" but its scope is definitely limited by provisions therein which expressly exclude several items from that broad definition. Among these exclusions is—

> property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business * * *.

From the foregoing provision, it is evident that if the property which a taxpayer sells is held as indicated therein, the gain realized on the sale cannot be treated as a capital gain but must be taxed as ordinary income.

It will also be seen that Section 117(a) (1) (B), *supra*, specifically indicates that real property used

in the trade or business is not to be included with those assets known as "capital assets". Section 117(j)(2), *supra*, does allow gains from the sale of such property (with certain qualifying provisions not material here) to be treated as gain from the sale of a capital asset within the meaning of Section 117(a), and taxpayer obviously relies on Section 117(j)(2). But taxpayer is in error as he does not correctly interpret Section 117(j)(1) which, in defining "property used in trade or business" specifically excludes "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Thus, when the property is so held, as the District Court found was true of the Westvaco tract in this case, Section 117(j) (2) is not applicable and any gain from the sale of such property must be treated as ordinary income.

B. *Factors to be considered in determining the issue*

It has been repeatedly held that the issue here is not only a question of ultimate fact but that the judgment of the District Court should be affirmed unless clearly erroneous. *Homann* v. *Commissioner*, 230 F. 2d 671 (C.A. 9th); *Cohn* v. *Commissioner*, 226 F. 2d 23 (C.A. 9th); *Galena Oaks Corp.* v. *Scofield*, 218 F. 2d 217 (C.A. 5th); *Stockton Harbor Indus. Co.* v. *Commissioner*, 216 F. 2d 638 (C.A. 9th), certiorari denied, 349 U.S. 904; *Williamson* v. *Commissioner*, 201 F. 2d 564 (C.A. 4th); *Mauldin* v. *Commissioner*, 195 F. 2d 714 (C.A. 10th), *Rollingwood Corp.* v. *Commissioner*, 190F. 2d 263 (C.A. 9th); *Rubino* v. *Commissioner*, 186 F. 2d 304 (C.A. 9th), certiorari denied, 342 U.S. 814; also see

United States v. *Gypsum Co.*, 333 U.S. 364, rehearing denied, 333 U.S. 869.

Consequently, as the issue here is essentially one of fact, its determination necessarily depends on the circumstances in each case but, before discussing the facts, we wish to point out certain factors which were relied on as tests in the above cases, as well as in many others, for determining the status of property in similar cases and which should be considered in reaching a decision here. Obviously, no one factor is controlling but among those which have been considered important are (1) the purpose for which the property has been acquired, (2) the activities of the taxpayer and those acting in his behalf or under his direction, (3) the continunity and frequency of sales as distinguished from isolated transactions, and (4) any other facts indicating that the sale or transaction was in furtherance of the taxpayer's occupation. *Cohn* v. *Commissioner*, *supra; Stockton Harbor Indus. Co.* v. *Commissioner*, *supra; Palos Verdes Corp.* v. *United States*, 201 F. 2d 256 (C.A. 9th); *Harriss* v. *Commissioner*, 143 F. 2d 279 (C.A. 2d); *Richards* v. *Commissioner*, 81 F. 2d 369 (C.A. 9th.)

As taxpayer here appears to take the position that the land sold to Westvaco was originally acquired for farming, it should be noted that the original purpose is not considered as important as the purpose for which the property is being held just prior to sale. *Rollingwood Corp.* v. *Commissioner*, *supra*, p. 266; *Mauldin* v. *Commissioner*, *supra; Friend* v. *Commissioner*, 198 F. 2d 285, 288 (C.A. 10th). However, the underlying reasons for a taxpayer's entering into the business of selling real estate are

not material. In other words, whether a taxpayer enters into such business by choice or is forced into it for some reason, the essential thing to note is whether the taxpayer has resorted to a method of disposing of his property which has made it available to customers in the ordinary course of a real estate business. If so, the gain from the sales of such property must be treated as ordinary gain. *Palos Verdes* v. *United States*, *supra*, p. 259; *Gruver* v. *Commissioner*, 142 F. 2d 363 (C.A. 4th); *Ehrman* v. *Commissioner*, 120 F. 2d 607 (C.A. 9th.)

Of course during the time that a taxpayer is holding property, it may be used in some way so as to produce revenue. Thus, as this Court has held, buildings may be rented or land may be used for farming and at the same time also be held for sale. See *Stockton Harbor Indus. Co.* v. *Commissioner*, *supra*, p. 654; *Cohn* v. *Commissioner*, *supra*; *Richards* v. *Commissioner*, *supra*. Moreover, the taxpayer does not have to be a licensed real estate dealer nor does he even have to engage personally in the business of selling since the necessary work can be done through agents. As this Court has held, the personal attention which a taxpayer gives to a business is not decisive as to whether a resulting profit is ordinary income or capital gain. *Welch* v. *Solomon*, 99 F. 2d 41, 43. Also see *Ehrman* v. *Commissioner*, *supra*. In *Rollingwood* v. *Commissioner*, *supra*, this Court pointed out that most of the cases dealing with the problem of whether property is held primarily for sale to customers in the ordinary course of trade or business involve situations where the taxpayer is engaged in some activity apart from his usual occupation and the question is whether this activity amounts to a business. In considering that

question in connection with the facts involved there, this Court then stated (pp. 266-267):

> The capital gains provisions are remedial provisions. Congress intended to alleviate the burden on a taxpayer whose property has increased in value over a long period of time from having the profits from sales taxed at graduated tax rates designed for a single year's income. The purpose is to protect "investment property" as distinguished from "stock in trade," or property bought and sold for a profit. It is our view that this policy was not meant to apply to a situation where one of the essential purposes in holding the property is sale.

C. *The District Court's decision is supported by the facts*

As the District Court properly held (R. 21), the taxpayer has the burden of proving that the real estate which he sold was held primarily for investment rather than primarily for sale. *Cohn* v. *Commissoiner, supra*, p. 24. The District Court also correctly decided that the taxpayer has not met that burden. Moreover, as we have already pointed out, the taxpayer now necessarily concedes that he has not met such burden as to the property sold in 1946 and 1947, nor the property sold in 1948 with the exception of that sold to the Westvaco corporation.

The District Court found, and taxpayer does not deny, that taxpayer purchased large numbers of vacant lots and other real estate during the past twenty years, that during such period he has frequently and continuously sold a substantial num-

ber of vacant lots and other real estate, and that he was engaged in the real estate business during 1946, 1947 and 1948. (R. 23.) The District Court also found that all of such real estate (including the tract sold to Westvaco) was purchased with the intention of selling it at a profit to any prospective purchaser and that all of the property which was sold had been held primarily for sale to customers in the ordinary course of taxpayer's real estate business. (R. 23-24.) These findings are also necessarily admitted by the taxpayer except as they apply to the Westvaco tract. The District Court did not, of course, separate that tract from the other property which he sold, and we submit that under the facts of this case it should not be separated.

The record shows that the land involved in this appeal was part of a 3000 acre tract which is located in Power County and is known as Michaud Flats. It was purchased in 1937 by taxpayer and Paul Evans, who was also in the real estate business. Between the time that such purchase was made and the sale of 210 acres therefrom to Westvaco, taxpayer and Evans made the following sales from the same tract of land: (R. 18, 31-33, 37, 39-40.)

(1) One sale of 80 acres to the city of Pocatello,

(2) One sale of 160 acres to the Indian Service,

(3) One sale, by condemnation, of 903 acres to the U. S. Air Force,

(4) 2 sales of 40 acres each to Jack Simplot.

As to the particular sale involved here, the record shows that when taxpayer was approached about such sale, he told the purchaser, without any hesitation or apparent unwillingness to consider a sale,

that he would be ready to begin negotiations for the sale upon his return from a trip to Tennessee; and upon his return, he and Evans decided, after various conferences with the purchaser, to make the sale. In attempting to explain their readiness to make that sale, as well as the others listed above, taxpayer testified that, while it had always been their plan to hold the Michaud Flats, they were willing to make a sale when it was in the public interest to do so. (R. 33-35.)

Taxpayer cites such testimony as proof that the land involved here was not held for sale. He also calls attention to Evans' testimony that he had never placed such land in the market with a view to selling it and that he had intended to keep it for farming. (R. 36-37.) But there is other testimony which taxpayer does not refer to and which shows a different intention, and the District Court, after hearing the witnesses and weighing all of their statements, considered this other testimony to be controlling.

The substance of the other testimony to which we refer is that all of the property which Evans and taxpayer purchased jointly (which includes the land involved here) was in fact held for sale "If the price was satisfactory". (R. 18.) In elaborating on this, Evans testified (R. 41-42):

> My answer to your question as to whether or not it is right that I thought I could sell it for a profit, *my answer is that anything I have I would sell for a profit including the Michaud Flats, if I wanted to.* * * * As to whether or not that is exactly why I decided to sell to Westvaco, my answer is yes, if the price is right anything I have is for sale. * * * I bought some other

> properties with F. M. Bistline in Bannock County and Power County and *I guess that my testimony that all of this was held for sale if the price was satisfactory would apply to all these properties.* (Italics supplied.)

As to the farming operations to which taxpayer refers the record shows that prior to the purchase by taxpayer and Evans of the Michaud Flats, the latter had owned a parcel of land in the vicinity and had used such land for grazing livestock. The record is not clear as to when Evans began using any part of the Michaud Flats for farming or grazing. Neither is it shown to what extent the land was so used. Taxpayer did testify that he never had any interest in the livestock affairs but that there was a 200 acre parcel in this tract of land that he and Evans had been farming since 1945. The record also shows that some effort has been made, principally it appears by Evans, to get water on this tract by drilling wells or by irrigation. (R. 31-32.) But it should be noted that the parcel which was sold to Westvaco had never been used for farming. As to this, Evans testified that the land sold to Westvaco was not only on the other side of the highway from that allegedly used for farming and/or grazing and was located some distance away from the latter but he also explained, as to the Westvaco tract, that "We didn't have water there for farming at that time. We never did dry farm the piece sold to Westvaco". (R.40-41.)

Of course land can be farmed and at the same time also be held primarily for sale to customers in the ordinary course of a real estate business. But we submit that in the instant case, the evidence shows

that the piece of land involved here had not been used for farming, as taxpayer contends, and it also appears that there was very little farming done on any portion of the Michaud Flats of which the land here was a part. Under such circumstances, taxpayer is in error in contending that the Westvaco tract was an integral part of a farming unit. But even if it were, we submit that in view of the evidence here, including that pertaining to taxpayer's real estate business and other transactions, the District Court was certainly warranted in finding that the Westvaco tract had been held primarily for sale and not for an investment.

D. *Errors in taxpayer's contentions*

Taxpayer has cited a large number of cases but as the question presented here is essentially one of fact, and the decisions of this Court and other courts, cited above, state the tests which have been applied in similar cases, we do not consider it necessary to discuss the cases on which taxpayer relies. We also believe that the cases we have cited, and our discussion of them, answer taxpayer's contentions. However, we also wish to point out certain errors on taxpayer's part.

It is taxpayer's first contention (Br. 13-16) that where real property is used in trade or business for more than 6 months it cannot be held primarily for sale to customers in the ordinary course of business. In other words, taxpayer contends that property "must fall into one category or the other". (Br. 14). But that is, of course, not a correct interpretation of the law. As we have pointed out, property is frequently used in what may be called a business

not connected with the selling of real estate and yet is held *primarily* for sale. This happens when as in *Cohn* v. *Commissioner*, *supra*, buildings are rented pending their sale, and as in *Stockton Harbor Indus. Co.* v. *Commissioner*, *supra*, where land was farmed pending the sale. In both cases, the gain from the sales which were made therein was held to be ordinary income because during the period prior to such sales, the property there was being held primarily for sale although it was also being used at the same time for the purposes indicated.

The taxpayer's second contention is that a taxpayer in the real estate business may also hold property as an investment and that profit from a sale of such property would be capital gain. (Br. 17-18.) We do not deny that this may be done but the obvious answer is that this was not what was done here. As the District Court pointed out, the taxpayer had the burden of proving that he had held the Westvaco tract merely as an investment but the evidence shows that it, like all the other property, was held primarily for sale.

The taxpayer's third and fourth contentions are, in substance, that since the sale here was not solicited by the owners of the land and was made with little activity on the taxpayer's part, the gain therefrom should be treated as gain from the sale of a capital asset. (Br. 18-20.) But, as this Court has held, the personal activity of the owner of the property which is sold is not a test to be applied in such a case as this. *Welch* v. *Solomon*, *supra*; *Ehrman* v. *Commissioner*, *supra*. The essential test is whether the property has been held primarily for sale to any customer in the ordinary course of the taxpayer's

business, and under the facts of this case, it is plain that the property here was so held.

CONCLUSION

The decision of the District Court is correct and should be affirmed.

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